

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No.

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

FACTUAL BACKGROUND OF CASE.

A statement of the facts surrounding the case is made in the preceding petition. Some further facts are recited under the following argument.

I.

THE PLAN IS UNFAIR AND DISCRIMINATORY AS TO PETITIONER NELSON TAYLOR.

His three bonds fell due August 15, 1930 (R. 41) and were presented for payment January 30, 1931, but

never paid. (R. 41.) All other bonds of the same maturity were paid, bonds of later maturities were paid (R. 118), and the plan provides for payment in full of all interest obligations through January 1, 1931. (R. 16.) Taylor's bonds are therefore the *only* bond obligations back of July 1, 1931 which are not paid in full. The fact of this non-payment is one point of discrimination and unfairness. The provision for payment in full of January 1, 1931 coupons is another point of discrimination and preference.

Under California law, bond obligations must only be paid in the order of their presentation for payment. (R. 180.) (Cal. Stat. 1931, p. 172; *Bates v. McHenry,* 123 Cal. App. 81, *Provident Land Corp. v. Zumwalt,* 12 Cal. (2d) 365.)[2] In bankruptcy, relative rights of parties cannot be changed. (*In re Lowmon,* 79 Fed. (2d) 887.)

At the hearing of this case, the non-payment of Taylor's bonds was called an "error" by counsel for the district. (R. 189.) He also stated, "I think it is true there aren't any bonds that are in the class of those three bonds". (R. 182.)

In 1935 two bonds of subsequent maturity (R. 181) and presentation were paid in full and several thousand dollars of interest coupons paid. (R. 118.) Also at various times there was money available for payment of these bonds.

The district declared a "surplus" of $10,000 and went out and bought bonds in the market. This procedure was condemned and set aside in the *Provident*

[2]Appendix p. i.

v. Zumwalt case and the money ordered returned to the bond fund *for payment of bonds and coupons "in the order of their presentation". We thus have an adjudication of the affairs of this district declaring that its bond obligations* must be paid in the order of presentation and the bankruptcy court was without authority to decide otherwise.

Not only did the district fail to pay Taylor's bonds as required, but in 1935 paid two bonds subsequent in date and paid $3120 of interest coupons and $1328.13 interest on registered bonds and coupons. (R. 118.)

In 1939 the district received $5500 of assessments which were also applicable by law to payment of these bonds. (R. 195.)

From time to time it had other moneys applicable to payment of Taylor's bonds. (R. 118, 191.) (*Provident v. Zumwalt,* supra.)

Thus the district, having "surplus" money to buy bonds on the market, deliberately refused for a period of years to pay the bonds first in right wrongfully contending they were "outlawed" even after being reprimanded by the Supreme Court of California for such procedure. (*Provident v. Zumwalt,* Appendix p. i.)

II.

THE HIGHEST COURT OF CALIFORNIA HAS ESTABLISHED THE FACTS AND LAW OF THIS PROCEEDING AND THE BANKRUPTCY COURT WAS BOUND TO FOLLOW SUCH DECISIONS, BUT DID NOT.

In the case of *Moody v. Provident Irrigation District,* 12 Cal. (2d) 389, involving one of the same parties and same bonds as here, the Supreme Court declared that such bonds after presentation for payment do not outlaw and by the act of presentation a new agreement is made whereby bonds are payable only as funds become available and notice is given. The effect is that bonds are not "due" until funds become available.

This matter is therefore *res judicata* as to this district, and the district cannot show that it is insolvent or unable to meet its debts as they mature (as required by the Bankruptcy Act) because there is no maturity until funds are available.

Secondly, the case of *Provident Land Corporation v. Zumwalt* declares that the lands of the Provident Irrigation District "remain in trust and the district exercises its powers, however broad, as a trustee" and the land "can never be permanently released from the obligation of the bonds until they are paid". (See Appendix.)

Thirdly, in the latter case the Supreme Court of California held that the $10,000 wrongfully diverted from payment of bond obligations of the district must be returned and used for payment of bond obligations "in the order of their presentation". The money was

returned but the bankruptcy court is permitting the district to evade that judgment in this proceeding. There are no landowners to save, and the Supreme Court indicates in strong words the reason back of the failure of the district to handle its affairs properly:

> "The true situation seems to be that the directors of the district by their present policy are administering the land for the benefit of lessees who are able to rent the land at exceptionally low prices and for those particular bond holders whose bonds are purchased and retired. The delinquencies have gone too far in this and other districts to save the landowners."

It is reiterated that these decisions were made on the very facts and law involved in this proceeding, and under the rule of *Erie Railroad v. Tompkins,* 304 U. S. 64, the bankruptcy court was bound to follow them. The highest state court is the final authority on state law. (*In re Mt. Forest Fur Farms,* 122 Fed. (2d) 232; *Ginsberg v. Lindel,* 107 Fed. (2d) 721.)

Especial respect should be shown state court decisions involving public lands and the taxing power. (*Wilson v. Standifer,* 184 U. S. 399, 412.)

III.

THE PLAN IS UNFAIR AND DISCRIMINATORY TO PETITIONERS.

(A) The district produced no exhibits of any character showing the assets of the district, showing any balance sheet, any crop returns of the district or containing any financial statement of the affairs of the district whatever. In a bankruptcy proceeding between trustee and beneficiary the confidential relationship, as well as ordinary bankruptcy procedure, require a full disclosure of financial affairs. (*Consolidated Rock Products Co. v. Du Bois,* 312 U. S. 510; *Preble Corp. v. Wentworth,* 84 Fed. (2d) 73.)

(B) Nearly 10,000 acres of land, owned by the district, and held for the benefit of the bondholders, and worth between $50,000 and $100,000, is to be excluded from the district without a cent compensation to bondholders. These lands of the district are held in trust, bondholders being beneficiaries under *Provident Land Corp. v. Zumwalt* (Appendix p. i); *Security First National Bank v. Rindge Land & Nav. Co.,* 85 Fed. (2d) 557.)

(C) The fiscal agent is receiving $20,300 for his services, representing more than 10% of the amount the bondholders are to receive, without disclosure to the court of the reasonableness of the compensation.

(D) The terms of the R. F. C. loan (R. 71, 76) provided that the size of the district was to be reduced from 22,805 acres of land to approximately 13,000 acres and the district was to discharge the lien

of overlapping drainage district indebtedness and to settle county taxes on approximately 12,000 acres of land owned by the district and to apply surplus funds to the reduction of indebtedness due the R. F. C. (R. 73-75.)

There were only three landowners remaining in the district and the district was in fact not only the owner of but was operating the bulk of the acreage of the district as a landlord. (See *Provident v. Zumwalt,* supra, and appendix.)

In *Anderson-Cottonwood v. Klukkert,* 13 Cal. (2d) 191, it was held that where an irrigation district owns land, such land is no longer subject to taxation by the county or other agency because the property is state owned and therefore free from taxation.

The lower court's determination that the titles of the various state agencies taken by tax process are of equal rank may be conceded as correct, but the practice, as the court below would take judicial notice, throughout the state and the facts pertaining to this district show that this district operated these lands as a landlord.

The *Provident v. Zumwalt* decision definitely determined that land rentals secure the bond issues and that the position of the district to the contrary was erroneous. It is in fact *res judicata* that all land rentals in the Provident Irrigation District, after payment of maintenance and operation, are to be applied to bond service. (Appendix p. i.)

Consequently, the reliance of the appellee upon the provisions of Section 3773 of the Political Code of California providing that the state has prior right to possession and sole power to lease and receive rents and profits was not well taken and has no practical application to this district in point of fact.

Furthermore, the plan of this district provides for the sale of all of its lands and as the Attorney General of the state ruled on December 29, 1941, in opinion 2 NS4002, the holder of a tax deed from the state would be a co-owner with the district.

> "If the former owner redeems from the sale to the State, he presumably re-acquires whatever interest the State had in the property. But if the district also has a tax title, or has sold its tax title to a purchaser, there are two claimants to the property and so far as I am able to ascertain the statutes do not determine the relative rights of these claimants. In this connection see La Mesa Irr. Dist. v. Hornbeck, 216 Cal. 730, and South San Joaquin Irr. Dist. v. Neumiller, 2 Cal. (2d) 485."

This opinion goes on to advise the State Controller that where the state has a tax title and an Irrigation District has a tax title, neither has a better title than the other and that

> "notwithstanding the fact that the district has contracted to sell the property to a third person, the former owner has the right to redeem at any time prior to the making and delivering of a deed."

And citing Section 47 of the California Irrigation District Act.

In this state of the law, it would appear that the most feasible plan would have been for the district to continue operating as a landlord and owner of the property, leasing it out, free of state and county taxes, for the sole and exclusive use and benefit of the beneficiaries of the trust declared in the *Provident v. Zumwalt* decision for the benefit of the bondholders.

In practical effect Congress finds itself unable to levy a direct tax on land under the constitution.

This court has said that "there is nothing in the history of bankruptcy reorganization legislation to support the theory that Congress intended to set the federal courts up as super-assessment agencies over State taxes."

Arkansas Corporation Comm. v. Thompson, 313 U. S. 132.

The serious question is raised whether the state can abdicate its powers as trustee of the public lands which the bankruptcy court so unquestionably distributes and disposes in these proceedings—both as regards lands excluded from the district and lands sold out from under the trust.

Secs. 17, 29, 74-80 "the California Irrigation District Act", Stat. Cal. 1897 p. 243 as amended.

Carter v. Carter Coal Co., 298 U. S. 238;

Ill. Centr. R. Co. v. Illinois, 146 U. S. 387, 452.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the court below reversed, and the proceeding directed to be dismissed.

Dated, Turlock, California,
February 2, 1942.

Respectfully submitted,
W. COBURN COOK,
Counsel for Petitioners.

(Appendix Follows.)